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**EX PARTE**



**United States Telephone Association**

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March 20, 1995

Mr. William F. Caton  
Secretary  
Federal Communications Commission  
1919 M Street, N.W. - Room 222  
Washington, D.C. 20554

**RECEIVED**

**MAR 20 1995**

**FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY**

**RE: Ex Parte Material  
CC Docket No. 94-1**

Dear Mr. Caton:

DOCKET FILE COPY ORIGINAL

On Friday, March 17, Mary McDermott, Ed Lowry and Whit Jordan representing USTA met in separate meetings with James Casserly of Commissioner Ness' office, Richard Welch of Commissioner Chong's office, and with James Coltharp and Keith Townsend of Commissioner Barrett's office. The discussion was consistent with USTA's filed position in this docket, and centered around four Ex Parte filings USTA has made earlier in the week. In addition, the attached material was shared.

The original and a copy of this ex parte notice are being filed in the Office of the Secretary. Please include it in the public record of this proceeding.

Sincerely,

A handwritten signature in cursive script that reads "Linda Kent". The signature is written in black ink and is positioned above the typed name and title.

Linda Kent  
Associate General Counsel  
Legal & Regulatory Affairs

cc: James Casserly  
James Coltharp  
Keith Townsend  
Richard Welch

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## **AT&T 1994 Annual Report**

**With 5% of the \$1.5 trillion  
global information industry,  
AT&T is a small fish with  
lots of room to grow.**



## An Overview of Our Business Operations

Our main business is meeting the communications and computing needs of our customers by using networks to move and manage information. We divide the revenues and costs of this business into three categories on our income statement: *telecommunications services, products and systems, and rentals and other services*. AT&T Capital Corporation (AT&T Capital) and AT&T Universal Card Services Corp. (Universal Card) are partners with our communications and computing business units as well as innovators in the financial services industry. We include their revenues and costs in a separate category on our income statement: *financial services and leasing*.

Competition in communications and computing is global and increasingly involves multinational firms and partners from different nations. To increase our global presence, we are hiring, building facilities and investing outside the U.S. We believe these commitments of resources are necessary to be successful in these markets. However, the economies of Europe and Japan were very weak in 1992 and 1993, and we restructured some operations in those areas. For these reasons we reported operating losses, in total, for the past three years in our units outside the U.S. Nevertheless, we continue to believe that these operations and markets provide excellent opportunities for future growth in revenues and earnings.

All our business units face stiff competition. Prices and technology are under continual pressure. Such market conditions make the ongoing need for cost controls even more urgent. Managers must continuously assess their resource needs and consider further steps to reduce costs, which could include consolidating facilities, disposing of assets, reducing workforce or withdrawing from markets.

In 1993 one of our business units, AT&T Global Information Solutions Company, offered an early retirement program and a voluntary separation program to its U.S.-based employees. About 2,200 employees accepted the early retirement offer, and the total workforce at the unit has declined by more than 10% since year-end 1993. We also provided reserves in 1993 to restructure and centralize support services for telecommunications services and for other restructuring activities. In total we provided \$498 million before taxes in 1993 for restructuring activities.

At year-end 1994 reserves for all restructuring activities amounted to about \$900 million, most of which relates to net lease payments to be made over the life of the related leases. We believe the balance of reserves is adequate for the completion of planned activities to improve efficiency

as part of our commitment to meet intense competition.

Like other manufacturers, we use, dispose of and clean up substances that are regulated under environmental protection laws. We also have been named a potentially responsible party (PRP) at a number of Superfund sites. At most of these sites, our share is very limited and there are other PRPs who can be expected to contribute to the cleanup costs. We review potential cleanup costs and costs of compliance with environmental laws and regulations regularly. Using engineering estimates of total cleanup costs, we estimate our potential liability for all currently and previously owned properties where some cleanup may be required, including each Superfund site where we are named a PRP. We provide reserves for these potential costs and regularly review the adequacy of our reserves. In addition, we forecast our expenses and capital expenditures for existing and planned compliance programs as part of our regular corporate planning process. Despite these procedures, it is very difficult to estimate the future impact of actions regarding environmental matters, including potential liabilities. However, we believe that cleanup costs and costs related to environmental proceedings and ongoing compliance with present laws will not have a material effect on our future expenditures, annual consolidated financial statements or competitive position beyond that provided for at year-end.

Many of our employees are represented by unions. In 1995 we will negotiate new labor agreements because the 1992 contracts are due to expire on May 27.

## Telecommunications Services

These revenues, which include wireless services revenues, grew 4.3% in 1994 and 1.6% in 1993. Volume growth, caused by market share gains among residential customers, strong demand from business customers, new cellular customers and the improved economy, fueled the faster growth in 1994.

Wireless services revenues, including cellular, messaging and air-to-ground services revenues, grew to \$2,280 million in 1994 from \$1,760 million in 1993 and \$1,387 million in 1992, primarily because of the added traffic coming from new customers. Cellular customers served by companies in which AT&T has or shares a controlling interest increased to 4.0 million at year-end 1994, from 3.0 million at the end of 1993 and 2.2 million at the end of 1992.

Billed minutes for switched long distance services rose more than 7.5% in 1994 compared with 5.5% in 1993. Volume growth exceeds revenue growth because many customers are selecting higher-value, lower-priced

## Reporting on the Merger

To complete the merger, McCaw's owners exchanged their McCaw stock for 197.5 million shares of newly issued AT&T stock. At the market closing price for AT&T stock on September 19, the official day of the merger,

that exchange was worth about \$11.5 billion.

We accounted for the merger as a pooling of interests. That means we combined the financial statements for the two companies. We did, however, take out the business

between the companies just as we remove dealings between other AT&T units. Now all our financial information shows combined amounts as if we had always been one company.

# Eleven-Year Summary of Selected Financial Data

(unaudited)  
AT&T Corp. and Subsidiaries

Dollars in millions (except per share amounts)

	1994	1993*	1992	1991*	1990	1989	1988*	1987	1986*	1985	1984
<b>Results of Operations</b>											
Total revenues	\$75,094	\$69,351	\$66,647	\$64,455	\$63,228	\$61,604	\$62,067	\$60,726	\$61,975	\$63,159	\$60,326
Research and development expenses	3,110	3,111	2,924	3,114	2,935	3,098	2,988	2,810	2,599	2,527	2,477
Operating income (loss)	8,030	6,568	6,628	1,570	5,622	4,931	(2,381)	4,164	978	3,562	2,825
Income (loss) before extraordinary item and cumulative effects of accounting changes	4,710	3,702	3,442	171	3,475	2,820	(1,527)	2,374	609	1,856	1,712
Net income (loss)	4,710	(5,906)	3,442	171	3,666	2,820	(1,527)	2,374	434	1,856	1,712
Earnings (loss) per common share before extraordinary item and cumulative effects of accounting changes	3.01	2.39	2.27	0.12	2.38	1.95	(1.06)	1.61	0.36	1.21	1.14
Earnings (loss) per common share	3.01	(3.82)	2.27	0.12	2.51	1.95	(1.06)	1.61	0.24	1.21	1.14
Dividends declared per common share	1.32	1.32	1.32	1.32	1.32	1.20	1.20	1.20	1.20	1.20	1.20
<b>Assets and Capital</b>											
Property, plant and equipment—net	\$22,035	\$21,015	\$20,798	\$19,887	\$19,536	\$17,653	\$16,886	\$22,159	\$22,247	\$23,182	\$22,180
Total assets	79,262	69,393	66,104	62,071	57,036	45,228	41,945	45,583	44,305	44,824	43,461
Long-term debt including capital leases	11,358	11,802	14,166	13,682	14,579	10,116	10,172	9,060	8,234	8,104	8,963
Common shareowners' equity	17,921	13,374	20,313	17,973	17,928	15,727	13,694	16,913	15,849	16,945	15,852
Net capital expenditures	4,853	4,296	4,328	4,376	4,369	4,162	4,528	3,936	3,977	4,303	3,685
<b>Other Information</b>											
Operating income (loss) as a percentage of revenues	10.7%	9.5%	10.0%	2.4%	8.9%	8.0%	(3.8)%	6.9%	1.6%	5.6%	4.7%
Net income (loss) as a percentage of revenues	6.3%	(8.5)%	5.2%	0.3%	5.8%	4.6%	(2.5)%	3.9%	0.7%	2.9%	2.8%
Return on average common equity	29.5%	(47.1)%	17.6%	0.9%	21.2%	19.1%	(8.9)%	14.3%	2.0%	10.6%	10.4%
Data at year-end:											
Stock price per share	\$50.25	\$52.50	\$51.00	\$39.125	\$30.125	\$45.50	\$28.75	\$27.00	\$25.00	\$25.00	\$19.50
Book value per common share	\$11.42	\$ 8.65	\$13.31	\$12.05	\$12.33	\$10.92	\$ 9.57	\$11.87	\$11.04	\$11.73	\$11.19
Debt ratio	58.3%	64.4%	53.1%	54.8%	53.5%	45.0%	45.8%	38.4%	39.6%	39.9%	42.0%
Debt ratio excluding financial services	34.1%	49.1%	40.8%	46.0%	47.6%	39.3%	42.2%	35.2%	37.6%	38.4%	41.7%
Employees	304,500	317,700	319,000	322,300	333,400	343,000	367,400	366,200	379,900	400,400	427,800

\* 1993 data reflect a \$9.6 billion net charge for three accounting changes.

1991 data reflect \$4.5 billion of business restructuring and other charges.

1988 data reflect a \$6.7 billion charge due to accelerated digitization of the long distance network.

1986 data reflect \$3.2 billion of charges for business restructuring, an accounting change and other items.

services made possible by our increasing efficiency. **Although we raised prices on basic services over the past two years, the shift in the mix of services that customers selected reduced average per-minute revenues in 1994 and 1993.**

AT&T True USA<sup>SM</sup> Savings and AT&T True Rewards<sup>SM</sup> offer savings and other benefits to residential customers based on their calling volumes. We also rolled out AT&T TrueVoice<sup>®</sup> service, a patented technology to improve the sound quality on calls placed within the continental U.S. and Canada. Other offers and calling plans now share this theme of offering customers true value. These efforts helped us retain and win back residential customers in 1994, allowing us to recapture some market share for the first time since the breakup of the Bell System in 1984.

We expect continuing strong volume growth in 1995, leading to further growth in telecommunications services revenues. Several of our initiatives will enhance future network capabilities for communications and computing. For example, since late 1994, Network Notes<sup>SM</sup> has enabled customers to access applications and information hosted on the AT&T network that are compatible with the popular Notes groupware software from Lotus Development Corp. Beginning in 1995, Netware Connect<sup>SM</sup> services, based on popular networking software from Novell, Inc., will enable users to link computers or use computer-based services through the AT&T network. Through our relationship with Xerox Corp., users will be able to store and transmit high-quality production documents through our network. Our WorldWorx<sup>SM</sup> service, developed in cooperation with several major equipment vendors, will permit interactive, multipoint video and data calls. Customers using our PersonaLink<sup>SM</sup> service may program "intelligent agents" to sort through, retrieve and monitor desired information on networks.

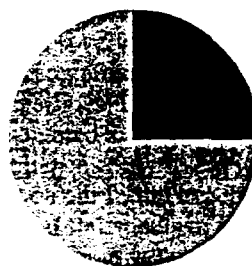
**Total cost of telecommunications services declined both years despite higher volumes, in part because of reduced prices for connecting customers through local networks.** In addition, we improved our efficiency in network operations,

engineering and operator services. With lower costs and higher revenues, the gross margin percentage rose to 41.8% in 1994 from 39.0% in 1993 and 37.2% in 1992.

## Products and Systems

Expansion abroad and into new customer segments, improved global economic conditions and major contract wins raised sales by 18.1% in 1994 and 8.1% in 1993 despite stiff price competition. Sales outside the U.S. grew at a faster rate than U.S. sales and were responsible for more than half the growth both years. We expect sales under major contracts and the continuing economic recovery outside the U.S. in 1995 to pave the way for further growth in revenues.

### 1994 Sources of Revenue As Percentages of Total Revenues



Markets and competition in the information industry are increasingly global in scope. Some of the fastest growing markets are outside the U.S.

- 10% ■ International Revenues From operations located in other countries
- 15% ■ International Revenues From U.S. operations (international telecommunications services, and exports)
- 75% ■ U.S. Revenues

Revenues from sales of telecommunications network products and systems grew 17.3% in 1994 and 8.5% in 1993. The 1994 increase reflected higher sales across this product line, particularly in switching and transmission systems and wireless products. About \$243 million of switching revenues in 1994 came from consolidating A.G. Communication Systems Corporation because AT&T raised its ownership to 80%. The 1993 increase came chiefly from higher sales of wireless products, switching equipment and operations systems. For the last two years, sales grew both inside and outside the U.S.

## Spotlight on Some Trends in Telecommunications Services

### Competition is changing.

As we look ahead, along with growing opportunities, we see more direct competition for AT&T coming from local telephone, long distance, cable television, wireless and other companies that offer network services. AT&T, as a supplier of networking systems, services and products, will be a supplier as well as a customer and competitor of these firms. There may also be other entrants from the communications and information services industries, such as providers of information systems, who will offer basic or integrated services.

Customers and competitors – present and future – are making acquisitions, merging, and forming joint ventures and alliances to expand their geographic reach, enter new markets

and gain scale. Some of the largest cable TV companies, such as Tele-Communications Inc. (TCI) and Time Warner Inc., are clustering cable systems. Cables have more capacity than current phone lines, suiting them for multimedia use. Bell Atlantic Corporation, Nynex Corporation, U S West, Inc. and Airtouch Communications Corp. formed an alliance of their cellular operations to gain a national presence and bid against AT&T and others for radio licenses to provide personal communications services. These licenses are being auctioned by the Federal Communications Commission to get as many as seven wireless competitors in each territory. Sprint Corporation (Sprint), which already competes in local phone service, long distance and cellular

markets, is forming a joint venture with cable companies TCI, Comcast Corp. and Cox Enterprises, Inc. to expand its presence in both local and wireless markets.

Several bills were introduced in Congress last year which would have accelerated competition for local access and phone services and permitted the Regional Bell Operating Companies (RBOCs) to offer long distance services under certain conditions. Although none of these bills was enacted, several key members of Congress have introduced or announced plans to introduce new bills during 1995 that would permit competition in local services and set conditions under which the RBOCs would be permitted to offer long distance services and manufacture equipment.

## Products and Systems

Dollars in millions	1994	1993	1992
Revenues			
Telecommunications network products and systems	\$ 9,785	\$ 8,345	\$ 7,691
Computer products and systems	4,208	3,470	3,358
Communications products and systems	4,494	3,692	3,279
Microelectronics products, special-design products for U.S. government, and other*	2,674	2,418	2,251
Products and systems	\$21,161	\$17,925	\$16,579
Gross margin percentage	37.3%	38.8%	39.8%

\*"Other" is composed principally of media, preeminantly for use with automated teller machines and point-of-sale equipment, and business forms.

AT&T was selected for several large projects for network products and systems over the past two years that we believe will lead to many sales opportunities in the years ahead. Pacific Bell and Bell Atlantic Corporation chose AT&T as the major equipment supplier and systems integrator for planned multimedia networks. These two projects alone could generate up to \$10 billion in revenues for AT&T over the next seven years. AT&T was also awarded major contracts by other U.S. telephone and cable companies, including Southern New England Telephone Corp. and Time Warner, Inc. Outside the U.S., AT&T won a \$4 billion contract with Saudi Arabia and signed a long-term system support agreement, worth about \$500 million over five years, with China's Guangdong province government agencies.

Revenues from sales of computer products and systems grew 21.3% in 1994 and 3.3% in 1993. The growth came mainly from higher U.S. sales of workstations, automated teller machines, and mid-range and high-end systems for enterprise-wide computing. Price competition for this product line is very fierce, particularly for personal computers, so revenue growth has lagged behind the gains in volumes. We changed the end of the fiscal year for certain

operations located outside the U.S. to December from November in 1994 to report essentially all of our operations on a calendar year. This added \$223 million in revenues and a marginal loss in income in 1994. About \$113 million of these revenues were from sales of computer products and systems.

Revenues from sales of communications products and systems rose 21.7% in 1994 and 12.6% in 1993. More than half this growth in both years came from higher sales of business communications products and systems. We also had higher sales of consumer communications products—particularly cellular phones—submarine cables and data communications equipment. AT&T Submarine Systems, Inc. and a partner were awarded a \$1.2 billion contract to supply and construct the 17,000-mile Fiber Optic Link Around the Globe (FLAG) cable system. This system is scheduled to be completed during 1997. We will manage the entire marine installation and also supply network management equipment.

In total, revenues from sales of microelectronics products, special-design products for the federal government, and other products and systems grew 10.6% in 1994 and 7.4% in 1993. Growth in both years came mainly from higher sales of microelectronics components and power systems to equipment manufacturers outside the U.S. Sales of media and business forms rose slightly in 1994, but were steady in 1993. Because of reduced defense spending by the U.S. government, sales of special-design products, such as secure phones, declined both years.

We sold several smaller operating units in 1994 and arranged to sell NCR Microelectronics and are negotiating to sell a copper cable unit in early 1995. These sales will reduce our revenues, as well as our costs and expenses, by about \$1 billion a year. Most of the revenues related to product sales, about half in the microelectronics products category.

The increase in cost of products and systems is mainly associated with the higher sales volumes both years. The declining gross margin percentage reflects pricing pressures and a changing product sales mix.

Some of the RBOCs are also seeking this same kind of permission through the courts. They requested relief from the decree that broke up the Bell System—the Modification of Final Judgment of 1982—including provisions that bar the RBOCs from offering long distance services and manufacturing equipment. We believe the RBOCs must face real competition for their local business before getting the permission they seek. Absent local competition they could use their bottleneck control over connections to customers to disadvantage competitors.

It is not possible to predict the timing, course and circumstances of changes that may come from technology, new alliances, regulation and legislation. We set a high priority on anticipating these changes and positioning AT&T for future success. However, depending on their exact nature and

timing, such changes could affect our future revenues and earnings adversely.

### Competition will be global, as legal monopolies disappear in other countries.

Mexico will open to competition beginning in late 1996. We are working with Grupo Alfa to plan a joint venture to compete there. Other U.S. companies—including MCI Communications Corp. (MCI), Sprint and GTE Corporation—have or plan alliances with Mexican companies to compete in telecommunications services.

The European Union is scheduled to be open fully to competition beginning in 1998, but some changes are coming sooner. At year-end 1994 we were granted a license to provide switched voice and data services and private lines within the United Kingdom (U.K.) and to resell services between the U.K. and other

countries. To better serve multinational businesses in Europe, we plan a joint venture with the Unisource consortium founded by PTT Telecom Netherlands, Swiss Telecom PTT and Telia of Sweden. Telefónica de España will also become a member. The new joint venture would then replace Unisource as the European partner in the AT&T-sponsored WorldPartners seamless global services alliance begun in 1993. British Telecommunications plc (BT) took a 20% stake in MCI in 1994, and they jointly formed a venture to compete in this same market sector.

Germany's Deutsche Telekom AG and France Telecom each seek approval to buy a 10% stake in Sprint, securing entry to the U.S. market similar to that of BT. We oppose their plans because the French and German telecommunications services markets remain fundamentally closed.



**Bringing  
People  
Together**

1993 Annual Report

# Anytime



# Anywhere

## Changes in our competitive landscape

### **Multimedia networks will lead to new ways of communicating and computing and new forms of education and entertainment.**

Telephone and cable television firms are forming alliances to speed their delivery of multimedia services to the home. A notable example is the proposed merger of Bell Atlantic Corp. and Tele-Communications Inc. Focusing on the programming to be provided by these networks, QVC Network Inc. and Viacom Inc. were competing to acquire Paramount Communications Inc., the entertainment company, at year-end.

Several firms are announcing major new networks. Pacific Bell's planned \$16 billion network is a good example. AT&T, as a supplier of network systems and services and a provider of multimedia products and services, will be a supplier as well as a customer and competitor of these firms.

The new alliances and networks, increas-

ing competition, and changes in technology and regulation are all leading to more choices for customers. These trends should also lower our costs to reach customers over local networks. Success in this new multimedia environment will depend on innovation and giving customers value for their purchases.

### **Competition is global and increasingly between multinational firms with partners from different nations.**

To offer one-stop shopping for telecommunications services to companies that do business globally, we formed WorldPartners with Kokusai Denshin Denwa Co. Ltd. of Japan and Singapore Telephone. We intend to also find European partners or build networks there ourselves, spending as much as \$350 million. British Telecom Plc and MCI Communications Corp. (MCI) also formed an alliance, as did Germany's Deutsche Bundespost Telekom and France Telecom.

British Telecom applied to the FCC to

provide long distance service in the U.S. We applied to provide service in the U.K. and also asked the FCC to prevent non-U.S. carriers from operating in the U.S. unless we can compete in their home markets.

We extended our rivalry with MCI to Canada through an alliance with Unitel Communications, Inc. MCI is allied with the Sientor consortium there. Mexico will open long distance services to competition from U.S. carriers in 1996 as part of the North American Free Trade Agreement (NAFTA). NAFTA should also aid our sales of network systems to Mexico.

In 1993 we signed an important agreement with the People's Republic of China, where we will compete with Canada's Northern Telecom Ltd., France's Alcatel Alsthom S.A., Sweden's Telefon AB L.M. Ericsson and possibly others. This past year we also won our first contract to supply switching equipment to Japan, a market that is dominated by Fujitsu Ltd. and NEC Corp.

Cost controls, coupled with our revenue growth, caused our gross margin percentage to improve the past two years. Operating expenses grew 7.5% in 1993, mainly because of marketing and sales efforts for telecommunications services and provisions for business restructuring. Such marketing and sales expenses also rose in 1992, but total operating expenses declined because of restructuring and other charges in 1991.

To increase our presence outside the U.S., we are hiring employees, building plants and forming joint ventures. However, during the past two years the economies of Europe and Japan were very weak and we needed to restructure some of our overseas operations. For these reasons we reported an operating loss in our operations outside the U.S. both years. Nevertheless, we continue to believe that these operations and markets provide excellent opportunities for future growth in revenues and earnings.

All our business units face stiff competition. Prices and technology are under continual pressure. Such market conditions, along with a slow-growing economy, make the ongoing need for active cost controls even more urgent. Managers must continuously assess their resource needs and consider further steps to reduce costs. Sometimes these steps will include consolidating facilities, disposing of assets, reducing work force or withdrawing from markets.

Like other manufacturers, we use, dispose of and clean up substances that are regulated under environmental protection laws. We also have been named a potentially responsible party (PRP) at a number of Superfund sites. At most of these sites, our share is very limited and there are other PRPs who can be expected to contribute to the cleanup costs. We review potential cleanup costs and costs of compliance with environmental laws and regulations regularly. Using engineering estimates of total cleanup costs, we estimate our potential liability for all currently and previously owned properties where some cleanup may be required, includ-

ing each Superfund site where we are named a PRP. We provide reserves for these potential costs and regularly review the adequacy of our reserves. In addition, we forecast our expenses and capital expenditures for existing and planned compliance programs as part of our regular corporate planning process. Despite these procedures, it is very difficult to estimate the future impact of actions regarding environmental matters, including potential liabilities to us. However, we believe that cleanup costs and costs related to environmental proceedings and ongoing compliance with present laws will not have a material effect on our future expenditures, earnings or competitive position beyond that provided for at year-end.

Many of our employees are represented by unions. In 1992 AT&T management and union bargainers negotiated innovative labor agreements with provisions for employees' career security and well-being as well as higher wages and increased employee ownership of the business. Under the wage portion of the agreements, employees at the top of each wage schedule received increases of 4% in 1992 and 3.9% in 1993, and will receive an increase of 3.9% in 1994. Pensions are increased by 13% for those who retire after May 31, 1992. The agreements also retained management flexibility to react to business conditions while enhancing education, training and job-changing opportunities for employees.

### **Telecommunications Services .....**

These revenues grew 0.7% in 1993 and 2.0% in 1992, driven by volume growth. Billed minutes for switched services rose 5.5% in 1993 and 6% in 1992, paced by business services. Volume growth exceeds revenue growth as customers select more of the higher-value, lower-priced services made possible by our greater efficiency. This shift in the mix of services that customers select lowers average per-minute revenues. In the latter



half of 1993 we raised some of our prices and fees — about \$500 million on an annual basis. These increases were primarily for services where customer demand is not very sensitive to price. In late December we filed for 1994 price increases of \$750 million on an annual basis and also announced a new discount plan for high-volume callers. We expect the effects on revenues of this discount plan and those 1994 price increases to offset each other. In January 1994 we also proposed to raise prices for some business services by \$165 million on an annual basis.

We expect improving economic conditions and higher prices to cause our telecommunications services to grow faster in 1994 than in 1993.

#### Telecommunications Services

Dollars in millions	1993	1992	1991
Total revenues	\$39,863	\$39,580	\$38,805
Costs			
Access and other inter-connection costs	17,709	18,132	18,395
Other costs	7,009	7,135	6,881
Total costs	24,718	25,267	25,276
Gross margin	\$15,145	\$14,313	\$13,529
Gross margin percentage	38.0%	36.2%	34.9%

This past year we announced AT&T *TrueVoice*<sup>®</sup> service, a new, patented technology to improve the sound quality on calls placed within the continental U.S. and Canada. We expect to complete the national rollout by April 1994 so that AT&T *TrueVoice* service will operate automatically on every call placed on our network. We believe it gives us a competitive advantage that will help us attract and keep customers.

Markets for telecommunications services are extremely competitive. AT&T is the market leader, but we saw another small decline in our market share this past year. Our own data and the data of the Federal Communications Commission (FCC) show that our market share is about 60% of the minutes billed for inter-LATA switched services. We withstood an important challenge to our market position when the FCC allowed customers of inbound "800" services to switch carriers without penalties for a 90-day period in 1993. We retained 95% of our 531 largest customers and won contracts away from our competitors. Many of these customers signed long-term contracts, so we emerged from this "Fresh Look" period with signed contracts having a greater dollar value than those we had before.

The FCC and state utility commissions regulate our services, and many more rules are imposed on us than on our competitors. Because of fierce competition and rapid changes in technology and customer needs, the FCC adopted "price caps" in 1989, increasing our flexibility to respond to those market conditions. Since then, the FCC has removed all limits on our prices for many business services. However, the FCC decided in June 1993 to continue price caps for residential services instead of reducing regulation of AT&T.

Total costs of telecommunications services declined this past year; costs in 1992 were about level with those in 1991. Despite higher calling volumes, access and other inter-connection costs dropped both years largely

because of lower prices from telephone companies to reach customers over local networks. The 1993 decrease in other costs was mainly due to lower uncollectibles. We also had lower depreciation expense because we reduced plant additions. The 1992 increase in other costs was associated with higher service volumes. We also had higher uncollectibles because of fraud and the weak economy.

#### Products and Systems .....

Despite a weak global economy and intense price competition, our sales grew 8.0% in 1993 and 3.3% in 1992. Sales outside the U.S. grew at a faster rate than U.S. sales and contributed more than half the increase in both years. Based on our current expectations for the global economy, we expect greater sales growth in 1994.

#### Products and Systems

Dollars in millions	1993	1992	1991
Revenues			
Telecommunications network products and systems	\$ 8,345	\$ 7,691	\$ 7,490
Computer products and systems	3,597	3,433	3,667
Communications products and systems	3,438	3,098	2,852
Microelectronics products, special-design products for U.S. government, and other <sup>a</sup>	2,418	2,251	1,932
Products and systems	17,798	16,473	15,941
Total costs	10,809	9,846	9,134
Gross margin	\$ 6,989	\$ 6,627	\$ 6,807
Gross margin percentage	39.3%	40.2%	42.7%

<sup>a</sup> "Other" is composed principally of media, predominantly for use with automated teller machines and point-of-sale equipment, and business forms.

Revenues from sales of telecommunications network products and systems grew 8.5% in 1993 and 2.7% in 1992. The 1993 increase came chiefly from higher sales of wireless products, switching equipment and operations systems. In 1992 the growth came mainly from higher sales of cable systems and switching equipment. Sales outside the U.S. rose both years while U.S. sales grew in 1993. Orders were heavily weighted toward the 1991 start of a seven-year, \$600 million contract to supply GTE Corporation with wireless equipment, so U.S. sales were lower in 1992.

Many countries are modernizing their communications networks. This will lead to many sales opportunities in the years ahead. We expect to partner with these countries because we provide a full range of integrated products and services and, sometimes, assistance in financing their equipment purchases.

In February 1993 we signed an agreement with the State Planning Commission of the People's Republic of China. Under that proposed partnership, we expect to engage in local research, development and manufacturing of central office switching equipment, cellular communications systems and telecommunications networks for use in that country.



## 1992 Annual Report

Anytime.



Anywhere

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of networks

### Telecommunications Services

Revenues from telecommunications services increased 2.0 percent in 1992 and 1.4 percent in 1991. Billed minutes for total switched services increased 6 percent in 1992 and 6.5 percent in 1991, with volume gains in all major service categories both years. The strongest gains in volumes were in outbound and inbound U.S. business services (WATS and 800 service families), and in international services.

We anticipate continued growth in telecommunications services industrywide in 1993 and believe the growth in our telecommunications services revenues will approach the industry rate.

Dollars in millions	1992	1991	1990
Total revenues	\$39,580	\$38,806	\$38,263
Access and other interconnection costs	18,132	18,395	18,572
Other costs	7,135	6,881	7,061
Total costs	25,267	25,276	25,633
Gross margin	\$14,313	\$13,529	\$12,630
Gross margin percentage	36.2%	34.9%	33.0%

The gain in revenues over the last two years trailed the volume gain for switched services because of the lower-priced, higher-value services we introduced. These services pass on to customers the savings from our increased operating efficiency and enable them to tailor our services to match their individual needs. This shift in the mix of services customers demand has lowered average per-minute revenues. Otherwise, market pricing trends are relatively stable.

Although we gained market share in some service categories, our overall share of the facilities-based long distance traffic declined slightly in 1992. However, our own data and the data of the Federal Communications Commission (FCC) show that our total share of this market remains above 60 percent.

Total cost of telecommunications services in 1992 was approximately level with 1991 and declined from 1990. Despite higher volumes, total access and other interconnection costs declined both years. We actively negotiate reduced prices for connections to customers, particularly outside the United States. The increase in other costs of telecommunications services in 1992 reflected higher service volumes and a larger provision for uncollectibles due to fraud and the weak economy. The 1991 decline in other costs was primarily due to lower network operating and maintenance costs.

Telecommunications services are regulated by the FCC and by state public utility commissions, and we remain more regulated than our competitors. Because of intense competition and rapid changes in technology and customer needs, the FCC adopted "price caps" in 1989, increasing our flexibility to respond to those market conditions. The FCC is currently engaged in a three-year review of the price caps and will decide whether to renew them or to further reduce regulation of AT&T.

In November 1992, a U.S. Court of Appeals ruled that the Communications Act requires all long distance carriers to publicly file their rates. That decision, which reversed an FCC policy that had permitted our competitors to negotiate prices with customers in secret, makes the regulation of AT&T and other long distance carriers slightly less unequal.

1992	1991*	1990	1989	1988*	1987	1986*	1985	1984	Jan. 1, 1984
\$4,964	\$63,089	\$62,191	\$61,100	\$61,756	\$60,530	\$61,908	\$63,130	\$60,318	
\$8,635	61,731	56,695	56,076	64,031	56,249	60,907	59,561	57,494	
3,307	522	3,104	3,108	(1,230)	2,463	476	1,872	1,713	
-	-	-	-	1	23	86	110	112	
3,307	522	3,104	3,108	(1,231)	2,440	390	1,762	1,601	
2.86	.40	2.42	2.40	(.94)	1.82	.29	1.31	1.23	
1.32	1.32	1.32	1.20	1.20	1.20	1.20	1.20	1.20	
\$19,358	\$18,689	\$18,661	\$17,023	\$16,394	\$21,866	\$22,061	\$23,133	\$22,187	\$21,416
77,188	53,355	48,322	42,187	39,969	44,014	43,617	44,683	43,418	39,156
8,604	8,484	9,354	8,377	8,360	8,027	7,789	8,026	8,948	9,462
-	-	-	-	-	82	912	1,457	1,494	1,523
18,921	16,228	15,883	14,728	13,705	16,617	15,946	16,961	15,839	14,413
3,923	3,880	4,018	3,951	4,288	3,305	3,904	4,295	3,685	
9.7%	2.2%	8.8%	8.2%	(3.7)%	7.1%	1.6%	5.7%	4.7%	
5.9%	0.8%	5.0%	5.1%	(2.0)%	4.1%	0.8%	3.0%	2.8%	
21.1%	3.1%	19.7%	21.8%	(7.2)%	15.0%	2.2%	10.7%	10.5%	
\$51.00	\$39.125	\$30.125	\$45.50	\$28.75	\$27.00	\$25.00	\$25.00	\$19.50	\$17.875
\$14.12	\$ 12.39	\$ 12.46	\$11.54	\$10.55	\$12.66	\$11.91	\$12.58	\$12.00	\$ 11.39
46.1%	48.9%	47.6%	43.0%	41.6%	36.1%	34.4%	34.5%	36.5%	40.1%
25.4%	34.7%	38.3%	36.3%	37.3%	32.5%	32.2%	32.9%	36.2%	40.1%
\$12,700	\$17,100	\$23,900	\$39,500	\$64,700	\$65,000	\$78,900	\$99,600	\$27,200	\$35,000

In January 1993, we announced an agreement to acquire a 20 percent equity interest in Unitel Communications, Inc., a Canadian long distance company, for cash and advanced telecommunications equipment valued at approximately \$120 million. We negotiated this alliance, which will include joint projects and marketing efforts, as a competitive response to an alliance between MCI Communications, Inc. and a consortium of Canadian telephone companies called Stentor.

In May 1993, business customers will be able to switch between long distance companies while retaining their advertised 800 numbers as a result of technology put in place at the local telephone companies. AT&T expects to gain some customers currently using the services of our competitors and lose some customers to those competitors. Some of our customers have waived their rights to switch between companies by signing long-term contracts with us that are suited to their particular needs and circumstances.

### Products and Systems

Sales of products and systems increased 3.3 percent in 1992, on the strength of a sharp rebound in the fourth quarter. Sales had declined in year-over-year comparisons for the first half of 1992 and 1.1 percent for all of 1991, primarily because of a weak global economy and price competition in most product categories. The 1992 sales increase was fueled by our continuing penetration of overseas markets. Also contributing to higher sales were several successful new product launches.

We expect improving economic conditions in 1993, particularly in the U.S., paving the way for further growth in sales of products and systems.

Dollars in millions	1992	1991	1990
Telecommunications network products and systems	\$ 7,711	\$ 7,490	\$ 7,303
Computer products and systems	3,433	3,667	4,120
Communications products and systems	3,098	2,852	2,837
Microelectronics products, special-design products for U.S. government, and other*	2,231	1,932	1,864
Sales of products and systems	16,473	15,941	16,124
Cost of products and systems	9,846	9,134	9,228
Gross margin	\$ 6,627	\$ 6,807	\$ 6,896
Gross margin percentage	40.2%	42.7%	42.8%

\*"Other" is composed of media and business forms, predominantly for use with automated teller machines and point-of-sale equipment, and sales of advanced decision support systems software.

Revenues from sales of telecommunications network products and systems increased 3.0 percent in 1992 and 2.6 percent in 1991, primarily because of double-digit growth in sales outside the U.S. This growth reflects our increasing market presence overseas, which should lead to many more sales opportunities in the years ahead. Many of the less-developed countries have plans for massive investment in their basic telecommunications infrastructures. AT&T is an attractive partner for many of these countries, offering a full range of integrated products and services and, sometimes, assistance in financing.

Sales to the Regional Bell Operating Companies were steady in 1992 after a decline in 1991. The RBOCs had reduced capital spending in a weak U.S. economy that had fewer housing starts and, consequently, slower telephone line growth. In addition, intense competition for sales to these customers created pricing pressure, reducing our revenues and margins. However, we successfully negotiated new sales contracts with several of the regional companies, and sales under those contracts contributed to strong fourth quarter 1992 sales.

Our other U.S. customers for telecommunications network products and systems include independent telephone companies, cellular service providers, building contractors and other specialized companies. Our sales of wireless products increased strongly in 1991 but declined in 1992, primarily as a result of the timing of orders under a major 1991 contract with GTE Corporation that is expected to produce \$600 million in total revenues over seven years.

Revenues from sales of computer products and systems decreased 6.4 percent in 1992 and 11.0 percent in 1991. The decline in 1992 was mainly the result of the loss of sales from some of AT&T's computer products that were phased out after the merger with NCR and because of the weak economy in Europe and Japan. The 1991 decrease reflected weak demand industrywide, principally due to the economy.

NCR management smoothly handled the integration of those portions of AT&T's Computer Systems unit that were retained. They also managed a first-quarter 1992 merger with Teradata Corporation, a leader in high-performance computer systems, parallel processing technologies and large database management. (See also Note C.) Despite these tasks and an economy that hurt many other suppliers of business information processing systems, the newly constituted NCR remains an important contributor to AT&T's earnings.

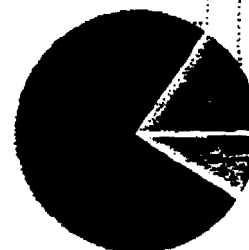
Revenues from sales of communications products and systems increased 3.6 percent in 1992 and 0.5 percent in 1991. Partly reflecting gains in market share in 1991, sales grew both years for consumer-

1992 International and Domestic Revenues in Percentages of Total Revenues

8.7% International Revenues From operations located in other countries

15.6% International Revenues From U.S. operations (international telecommunications services and export sales)

75.7% U.S. Revenues



AT&T is expanding its international presence, capitalizing on new opportunities.

## Baby-Bell Watchers Ponder the Unthinkable: Which Might Be the First to Cut Its Dividend?

### HEARD ON THE STREET

By SUSAN PULLIAM  
And LESLIE CAULEY

Staff Reporters of THE WALL STREET JOURNAL

A dividend cut by a Baby Bell? Why, that would be like messing with Mother Nature.

The regional Bell operating companies don't even want to talk about the possibility of cutting the vaunted dividend — much less do the deed — because their stocks could get hammered. Yet the question keeps popping up on Wall Street: Which Baby Bell might be first to puncture the payout in the next year or so?

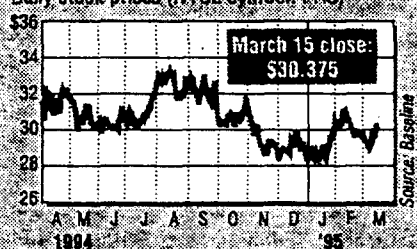
The dividend dilemma is most stark for Pacific Telesis Group, which has a 7.2% dividend payout, far and away the highest among the Baby Bells. "PacTel undoubtedly faces the greatest balancing act" when it comes to financing its growth strategy while maintaining a high dividend payout, says Andrew Bischel of money manager Spare, Tengler Kaplan & Bischel in San Francisco, a PacTel shareholder.

Like other Baby Bells, Pacific Telesis hasn't any plans to change its annual dividend "at this time," says Jeffrey Heyser, executive director of investor relations. Moreover, Mr. Heyser says the Baby Bell expects to fund the large majority of its existing and planned projects without issuing debt or new equity — or cutting the dividend. However, he concedes that the company's first big expenditure will be funded by issuing short-term debt.

Why are some investors wondering about the Bells' dividends now, when a cut might not come for months or even years? The government's auction of "personal-communications services," or PCS, licenses has reminded investors that the Bells' efforts to morph themselves into growth companies won't come cheaply. Sooner or later, one of them "will cut the dividend—it's just a matter of when," says Scott Billeadeau, portfolio manager with Bank of America's Pacific Horizon aggressive-growth fund.

### Pacific Telesis Group

Daily stock prices (NYSE symbol: PAC)



#### Business: Telephone Service

In millions	1994	1993
Revenue	\$9,235	\$9,244
Earnings	\$1,159	-\$1,504
Share earnings	\$2.73	-\$3.63

Latest quarter (Dec. 1994)

Per-share earnings: \$0.62 vs. -\$0.92

Average daily volume: 642,435 shares

Shares outstanding: 424.1 million

Trailing P/E: 11 Dividend yield: 7.2%

Includes \$1.43 billion credit charges related to restructuring and \$1.72 billion charge from accounting change

Why is that? The Baby Bells are racing ahead with costly expansions into such areas as cellular-phone and cable-television services. Meanwhile, competition looms ever larger in their once exclusive local-telephone realms. As one big shareholder puts it: "The Bells face an inherent conflict. What they want to do as companies is in conflict with what their current shareholders want" — namely, fat dividends.

"They are literally in a dividend strait-jacket," says Merrill Lynch analyst Daniel Reingold. The industry's worst fears were confirmed when Bell Atlantic's share price plummeted after announcement of its now-shelved plans to merge with Tele-Communications Inc. And Bell Atlantic had suggested at the time merely that the dividend would stay flat.

Bell company managers keep urging shareholders not to worry, envisioning a "soft landing" that will allow entry into new businesses through internally generated cash. It may take longer, but such plans would allow them to avoid touching the dividend, they say; meanwhile, earnings would perk up and growth investors would begin to move in. "The very Wall Street people who fully realize the need for the Bells to invest in growth opportunities would be the very first to react negatively to any change in the dividend policy," one Baby Bell executive says.

Pacific Telesis' payout continues to be the highest among the seven Bells, totaling 80% of its net income. The Bell average is 68%, with SBC Communications, the San Antonio-based regional phone company, at just 52%.

PCS licenses alone are costing Pacific Telesis \$695 million. Mr. Heyser said the Bell expects to fund the expenditure by issuing commercial paper within the next six months.

The question is, how much more of its capital-spending requirement over the next several years will need to come from external sources. The company says it can handle most of its heavy spending requirements internally, including between \$500 million and \$700 million needed to put in the PCS network.

In addition, Telesis will have to pony up as much as \$2 billion to AT&T Corp. in 1998 to pay for its spanking-new interactive video network.

If it needs cash, Telesis "has enormous capability to go to the capital markets or take on additional debt," now at about \$5 billion, Mr. Heyser said. That may be, but financing its expansion entirely with debt could jeopardize its currently stellar credit rating, at least one analyst says. And dilution from issuance of more equity to pay for its plans wouldn't necessarily sit well with shareholders, either.

"We shouldn't be in a situation where the dividend in 2000 is more of a burden than it is now," Mr. Heyser asserts. Maybe. But that assumes its core telephone business remains strong. That could change once competition starts to take hold in the California market. And it may take years before its investment in cable and other new technology pays off.